

108TH CONGRESS
1ST SESSION

S. 2

IN THE SENATE OF THE UNITED STATES

Mr. NICKLES (for himself and Mr. MILLER) (by request) introduced the following bill; which was read twice and referred to the Committee on

A BILL

To amend the Internal Revenue Code of 1986 to provide additional tax incentives to encourage economic growth.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; REFERENCES; TABLE OF CON-**
4 **TENTS.**

5 (a) SHORT TITLE.—This Act may be cited as the
6 “Jobs and Growth Tax Act of 2003”.

7 (b) AMENDMENT OF 1986 CODE.—Except as other-
8 wise expressly provided, whenever in this Act an amend-
9 ment or repeal is expressed in terms of an amendment
10 to, or repeal of, a section or other provision, the reference

1 shall be considered to be made to a section or other provi-
2 sion of the Internal Revenue Code of 1986.

3 (c) TABLE OF CONTENTS.—The table of contents of
4 this Act is as follows:

Sec. 1. Short title; references; table of contents.

TITLE I—ACCELERATION OF CERTAIN PREVIOUSLY ENACTED
TAX REDUCTIONS; INCREASED EXPENSING FOR SMALL BUSI-
NESSES

Sec. 101. Acceleration of 10-percent individual income tax rate bracket expansion.

Sec. 102. Acceleration of reduction in individual income tax rates.

Sec. 103. Acceleration of 15-percent individual income tax rate bracket expansion for married taxpayers filing joint returns.

Sec. 104. Acceleration of increase in standard deduction for married taxpayers filing joint returns.

Sec. 105. Acceleration of increase in child tax credit.

Sec. 106. Increased expensing for small business.

Sec. 107. Minimum tax relief to individuals.

Sec. 108. Application of EGTRRA sunset to this title.

TITLE II—DIVIDEND EXCLUSION TO ELIMINATE DOUBLE
TAXATION OF CORPORATE EARNINGS

Sec. 201. Dividend exclusion to eliminate double taxation of corporate earnings.

Sec. 202. Rules for application of dividend exclusion and retained earnings basis adjustments.

Sec. 203. Treatment of regulated investment companies and real estate investment trusts.

Sec. 204. Treatment of insurance companies.

Sec. 205. Treatment of S corporations.

Sec. 206. Repeal of accumulated earnings tax and personal holding company tax.

Sec. 207. Effective dates.

1 **TITLE I—ACCELERATION OF**
2 **CERTAIN PREVIOUSLY EN-**
3 **ACTED TAX REDUCTIONS; IN-**
4 **CREASED EXPENSING FOR**
5 **SMALL BUSINESSES**

6 **SEC. 101. ACCELERATION OF 10-PERCENT INDIVIDUAL IN-**
7 **COME TAX RATE BRACKET EXPANSION.**

8 (a) IN GENERAL.—Clause (i) of section 1(i)(1)(B)
9 (relating to the initial bracket amount) is amended by
10 striking “(\$12,000 in the case of taxable years beginning
11 before January 1, 2008)”.

12 (b) INFLATION ADJUSTMENT BEGINNING IN 2003.—
13 Section 1(i)(1)(C) (relating to inflation adjustment) is
14 amended to read as follows:

15 “(C) INFLATION ADJUSTMENT.—In pre-
16 scribing the tables under subsection (f) which
17 apply with respect to taxable years beginning in
18 calendar years after 2002—

19 “(i) the cost-of-living adjustment used
20 in making adjustments to the initial brack-
21 et amount shall be determined under sub-
22 section (f)(3) by substituting ‘2001’ for
23 ‘1992’ in subparagraph (B) thereof, and

1 “(ii) such adjustment shall not apply
 2 to the amount referred to in subparagraph
 3 (B)(iii).

4 If any amount after adjustment under the pre-
 5 ceding sentence is not a multiple of \$50, such
 6 amount shall be rounded to the next lowest
 7 multiple of \$50.”.

8 (c) EFFECTIVE DATE.—

9 (1) IN GENERAL.—The amendments made by
 10 this section shall apply to taxable years beginning
 11 after December 31, 2002.

12 (2) TABLES FOR 2003.—The Secretary of the
 13 Treasury shall modify each table which has been
 14 prescribed for taxable years beginning in 2003 and
 15 which relates to any amendment made by this sec-
 16 tion, section 102, or section 103 to reflect each such
 17 amendment.

18 **SEC. 102. ACCELERATION OF REDUCTION IN INDIVIDUAL**
 19 **INCOME TAX RATES.**

20 (a) IN GENERAL.—The table in paragraph (2) of sec-
 21 tion 1(i) (relating to reductions in rates after June 30,
 22 2001) is amended to read as follows:

“In the case of taxable years beginning during calendar year:	The corresponding percentages shall be substituted for the following percentages:			
	28%	31%	36%	39.6%
2001	27.5%	30.5%	35.5%	39.1%
2002	27.0%	30.0%	35.0%	38.6%
2003 and thereafter	25.0%	28.0%	33.0%	35.0%”.

1 (b) EFFECTIVE DATE.—The amendment made by
2 this section shall apply to taxable years beginning after
3 December 31, 2002.

4 **SEC. 103. ACCELERATION OF 15-PERCENT INDIVIDUAL IN-**
5 **COME TAX RATE BRACKET EXPANSION FOR**
6 **MARRIED TAXPAYERS FILING JOINT RE-**
7 **TURNS.**

8 (a) IN GENERAL.—Paragraph (8) of section 1(f) (re-
9 lating to phaseout of marriage penalty in 15-percent
10 bracket) is amended to read as follows:

11 “(8) ELIMINATION OF MARRIAGE PENALTY IN
12 15-PERCENT BRACKET.—With respect to taxable
13 years beginning after December 31, 2002, in pre-
14 scribing the tables under paragraph (1)—

15 “(A) the maximum taxable income in the
16 15 percent rate bracket in the table contained
17 in subsection (a) (and the minimum taxable in-
18 come in the next higher taxable income bracket
19 in such table) shall be 200 percent of the max-
20 imum taxable income in the 15-percent rate
21 bracket in the table contained in subsection (c)
22 (after any other adjustment under this sub-
23 section), and

24 “(B) the comparable taxable income
25 amounts in the table contained in subsection

1 (d) shall be $\frac{1}{2}$ of the amounts determined
2 under subparagraph (A).”.

3 (b) CONFORMING AMENDMENTS.—

4 (1) The heading for subsection (f) of section 1
5 is amended by striking “PHASEOUT” and inserting
6 “ELIMINATION”.

7 (2) Section 302(c) of the Economic Growth and
8 Tax Relief Reconciliation Act of 2001 is amended by
9 striking “2004” and inserting “2002”.

10 (c) EFFECTIVE DATE.—The amendments made by
11 this section shall apply to taxable years beginning after
12 December 31, 2002.

13 **SEC. 104. ACCELERATION OF INCREASE IN STANDARD DE-**
14 **DUCTION FOR MARRIED TAXPAYERS FILING**
15 **JOINT RETURNS.**

16 (a) IN GENERAL.—Paragraph (2) of section 63(c)
17 (relating to basic standard deduction) is amended to read
18 as follows:

19 “(2) BASIC STANDARD DEDUCTION.—For pur-
20 poses of paragraph (1), the basic standard deduction
21 is—

22 “(A) 200 percent of the dollar amount in
23 effect under subparagraph (C) for the taxable
24 year in the case of—

25 “(i) a joint return, or

1 “(ii) a surviving spouse (as defined in
2 section 2(a)),
3 “(B) \$4,400 in the case of a head of
4 household (as defined in section 2(b)), or
5 “(C) \$3,000 in any other case.”.

6 (b) CONFORMING AMENDMENTS.—

7 (1) Section 63(c)(4) is amended by striking
8 “(2)(D)” each place it occurs and inserting
9 “(2)(C)”.

10 (2) Section 63(c) is amended by striking para-
11 graph (7).

12 (3) Section 301(d) of the Economic Growth and
13 Tax Relief Reconciliation Act of 2001 is amended by
14 striking “2004” and inserting “2002”.

15 (c) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to taxable years beginning after
17 December 31, 2002.

18 **SEC. 105. ACCELERATION OF INCREASE IN CHILD TAX**
19 **CREDIT.**

20 (a) IN GENERAL.—Subsection (a) of section 24 (re-
21 lating to child tax credit) is amended to read as follows:

22 “(a) ALLOWANCE OF CREDIT.—There shall be al-
23 lowed as a credit against the tax imposed by this chapter
24 for the taxable year with respect to each qualifying child
25 of the taxpayer an amount equal to \$1,000.”.

1 (b) ADVANCE PAYMENT OF PORTION OF INCREASED
2 CREDIT IN 2003.—

3 (1) IN GENERAL.—Subchapter B of chapter 65
4 (relating to abatements, credits, and refunds) is
5 amended by adding at the end the following new sec-
6 tion:

7 **“SEC. 6429. ADVANCE PAYMENT OF PORTION OF IN-**
8 **CREASED CHILD CREDIT.**

9 “(a) IN GENERAL.—Each eligible taxpayer shall be
10 treated as having made a payment against the tax imposed
11 by chapter 1 for such taxpayer’s first taxable year begin-
12 ning in 2002 in an amount equal to the child tax credit
13 refund amount.

14 “(b) ELIGIBLE TAXPAYER.—For purposes of this
15 section, the term ‘eligible taxpayer’ means any taxpayer
16 if—

17 “(1) such taxpayer was allowed a credit under
18 section 24 for such taxpayer’s first taxable year be-
19 ginning in 2002, and

20 “(2) at least one qualifying child (as defined in
21 section 24(c)) of the taxpayer for such year meets
22 the age requirement for 2003.

23 “(c) CHILD TAX CREDIT REFUND AMOUNT.—

1 “(1) IN GENERAL.—For purposes of this sec-
2 tion, the child tax credit refund amount is equal to
3 the excess (if any) of—

4 “(A) the amount which would have been
5 allowed as a credit under section 24 for the tax-
6 payer’s first taxable year beginning in 2002
7 if—

8 “(i) the per child amount for such
9 year were \$1,000, and

10 “(ii) only qualifying children (as de-
11 fined in section 24(c)) of the taxpayer for
12 such year who meet the age requirement
13 for 2003 were taken into account, over

14 “(B) the amount which would have been
15 allowed as a credit under section 24 for the tax-
16 payer’s first taxable year beginning in 2002 if
17 only qualifying children (as defined in section
18 24(c)) of the taxpayer for such year who meet
19 the age requirement for 2003 were taken into
20 account.

21 “(2) ADJUSTMENTS.—The amounts described
22 in subparagraphs (A) and (B) of paragraph (1) shall
23 be determined—

24 “(A) without regard to section
25 24(d)(1)(B)(ii), and

1 “(B) as if the credit allowed under section
2 24(d) were allowed under section 24.

3 “(d) AGE REQUIREMENT.—A child of a taxpayer
4 meets the age requirement for 2003 if such child meets
5 the requirement of section 24(c)(1)(B) for the taxpayer’s
6 first taxable year beginning in 2003.

7 “(e) TIMING OF PAYMENTS.—In the case of any over-
8 payment attributable to this section, the Secretary shall,
9 subject to the provisions of this title, refund or credit such
10 overpayment as rapidly as possible and, to the extent prac-
11 ticable, before December 31, 2003.

12 “(f) COORDINATION WITH CHILD TAX CREDIT.—

13 “(1) IN GENERAL.—The amount of credit
14 which would (but for this paragraph) be allowable
15 under section 24 for the taxpayer’s first taxable year
16 beginning in 2003 shall be reduced (but not below
17 zero) by the aggregate refunds and credits made or
18 allowed to the taxpayer under this section. Any fail-
19 ure to so reduce the credit shall be treated as arising
20 out of a mathematical or clerical error and assessed
21 according to section 6213(b)(1).

22 “(2) JOINT RETURNS.—In the case of a refund
23 or credit made or allowed under this section with re-
24 spect to a joint return, half of such refund or credit

1 shall be treated as having been made or allowed to
2 each individual filing such return.

3 “(g) NO INTEREST.—No interest shall be allowed on
4 any overpayment attributable to this section.”.

5 (2) CLERICAL AMENDMENT.—The table of sec-
6 tions for subchapter B of chapter 65 is amended by
7 adding at the end the following new item:

“Sec. 6429. Advance payment of portion of increased child credit.”.

8 (c) EFFECTIVE DATES.—

9 (1) SUBSECTION (a).—The amendment made
10 by subsection (a) shall apply to taxable years begin-
11 ning after December 31, 2002.

12 (2) SUBSECTION (b).—The amendments made
13 by subsection (b) shall take effect on the date of the
14 enactment of this Act.

15 **SEC. 106. INCREASED EXPENSING FOR SMALL BUSINESS.**

16 (a) IN GENERAL.—Paragraph (1) of section 179(b)
17 (relating to dollar limitation) is amended to read as fol-
18 lows:

19 “(1) DOLLAR LIMITATION.—The aggregate cost
20 which may be taken into account under subsection
21 (a) for any taxable year shall not exceed \$75,000.”.

22 (b) INCREASE IN QUALIFYING INVESTMENT AT
23 WHICH PHASEOUT BEGINS.—Paragraph (2) of section
24 179(b) (relating to reduction in limitation) is amended by
25 striking “\$200,000” and inserting “\$325,000”.

1 (c) OFF-THE-SHELF COMPUTER SOFTWARE.—Para-
2 graph (1) of section 179(d) (defining section 179 prop-
3 erty) is amended to read as follows:

4 “(1) SECTION 179 PROPERTY.—For purposes
5 of this section, the term ‘section 179 property’
6 means property—

7 “(A) which is—

8 “(i) tangible property (to which sec-
9 tion 168 applies), or

10 “(ii) computer software (as defined in
11 section 197(e)(3)(B)) which is described in
12 section 197(e)(3)(A)(i) and to which sec-
13 tion 167 applies,

14 “(B) which is section 1245 property (as
15 defined in section 1245(a)(3)), and

16 “(C) which is acquired by purchase for use
17 in the active conduct of a trade or business.

18 Such term shall not include any property described
19 in section 50(b) and shall not include air condi-
20 tioning or heating units.”.

21 (d) ADJUSTMENT OF DOLLAR LIMIT AND PHASEOUT
22 THRESHOLD FOR INFLATION.—Subsection (b) of section
23 179 (relating to limitations) is amended by adding at the
24 end the following new paragraph:

25 “(5) INFLATION ADJUSTMENTS.—

1 “(A) IN GENERAL.—In the case of any
2 taxable year beginning in a calendar year after
3 2003, the dollar amounts in paragraphs (1) and
4 (2) shall each be increased by an amount equal
5 to—

6 “(i) such dollar amount, multiplied by

7 “(ii) the cost-of-living adjustment de-
8 termined under section 1(f)(3) for the cal-
9 endar year in which the taxable year be-
10 gins, by substituting ‘calendar year 2002’
11 for ‘calendar year 1992’ in subparagraph
12 (B) thereof.

13 “(B) ROUNDING.—

14 “(i) DOLLAR LIMITATION.—If the
15 amount in paragraph (1) as increased
16 under subparagraph (A) is not a multiple
17 of \$1,000, such amount shall be rounded
18 to the nearest multiple of \$1,000.

19 “(ii) PHASEOUT AMOUNT.—If the
20 amount in paragraph (2) as increased
21 under subparagraph (A) is not a multiple
22 of \$10,000, such amount shall be rounded
23 to the nearest multiple of \$10,000.”.

1 (e) REVOCATION OF ELECTION.—Paragraph (2) of
2 section 179(c) (relating to election irrevocable) is amended
3 to read as follows:

4 “(2) REVOCATION OF ELECTION.—The tax-
5 payer may revoke an election under paragraph (1),
6 and any specification contained in any such election,
7 with respect to any property. Such revocation, once
8 made, shall be irrevocable.”.

9 (f) EFFECTIVE DATE.—The amendments made by
10 this section shall apply to taxable years beginning after
11 December 31, 2002.

12 **SEC. 107. MINIMUM TAX RELIEF TO INDIVIDUALS.**

13 (a) IN GENERAL.—So much of paragraph (1) of sec-
14 tion 55(d) (relating to exemption amount for taxpayers
15 other than corporations) as precedes subparagraph (C)
16 thereof is amended to read as follows:

17 “(1) EXEMPTION AMOUNT FOR TAXPAYERS
18 OTHER THAN CORPORATIONS.—In the case of a tax-
19 payer other than a corporation, the term ‘exemption
20 amount’ means as follows:

21 “(A) JOINT RETURN AND SURVIVING
22 SPOUSE.—In the case of a joint return or a sur-
23 viving spouse, the amount under the following
24 table:

“In the case of taxable years beginning: The exemption amount is:

Before 2001	\$45,000.
In 2001 and 2002	\$49,000.
In 2003, 2004, and 2005	\$57,000.
After 2005	\$45,000.

1 “(B) INDIVIDUAL NOT MARRIED AND NOT
2 A SURVIVING SPOUSE.—In the case of an indi-
3 vidual who is not a married individual and is
4 not a surviving spouse, the amount under the
5 following table:

“In the case of taxable years beginning: The exemption amount is:

Before 2001	\$33,750.
In 2001 and 2002	\$35,750.
In 2003, 2004, and 2005	\$39,750.
After 2005	\$33,750.”.

6 (b) CONFORMING AMENDMENTS.—

7 (1) Section 55(d)(1)(C) is amended—

8 (A) by striking “, and” and inserting a pe-
9 riod, and

10 (B) by striking “50 percent” and inserting
11 “MARRIED INDIVIDUAL FILING A SEPARATE RE-
12 TURN.—50 percent”.

13 (2) Section 55(d)(1)(D) is amended by striking
14 “\$22,500” and inserting “ESTATE AND TRUST.—
15 \$22,500”.

16 (c) EFFECTIVE DATE.—The amendments made by
17 this section shall apply to taxable years beginning after
18 December 31, 2002.

1 **SEC. 108. APPLICATION OF EGTRRA SUNSET TO THIS TITLE.**

2 Each amendment made by this title (other than sec-
3 tion 106) shall be subject to title IX of the Economic
4 Growth and Tax Relief Reconciliation Act of 2001 to the
5 same extent and in the same manner as the provision of
6 such Act to which such amendment relates.

7 **TITLE II—DIVIDEND EXCLUSION**
8 **TO ELIMINATE DOUBLE TAX-**
9 **ATION OF CORPORATE EARN-**
10 **INGS**

11 **SEC. 201. DIVIDEND EXCLUSION TO ELIMINATE DOUBLE**
12 **TAXATION OF CORPORATE EARNINGS.**

13 (a) IN GENERAL.—Part III of subchapter B of chap-
14 ter 1 is amended by inserting after section 115 the fol-
15 lowing new section:

16 **“SEC. 116. DIVIDEND EXCLUSION TO ELIMINATE DOUBLE**
17 **TAXATION OF CORPORATE EARNINGS.**

18 “(a) EXCLUSION.—Gross income does not include the
19 excludable portion (as defined in section 281) of any
20 amount received as a dividend.

21 “(b) COMPARABLE TREATMENT FOR RETAINED
22 EARNINGS.—If the excludable dividend amount (as de-
23 fined in section 281) of any corporation for any calendar
24 year exceeds the dividends paid by the corporation in such
25 calendar year, the basis of stock in the corporation shall

1 be increased in the manner and to the extent provided in
2 section 282.

3 “(c) REPORTING TO SHAREHOLDERS.—For reporting
4 to shareholders, see section 6042.”

5 (b) CLERICAL AMENDMENT.—The table of sections
6 for such part III is amended by inserting after the item
7 relating to section 115 the following new item:

“Sec. 116. Dividend exclusion to eliminate double taxation of corporate earnings.”

8 **SEC. 202. RULES FOR APPLICATION OF DIVIDEND EXCLU-**
9 **SION AND RETAINED EARNINGS BASIS AD-**
10 **JUSTMENTS.**

11 (a) IN GENERAL.—Subchapter B of chapter 1 (as
12 amended by subsection (d)) is amended by inserting after
13 part IX the following new part:

14 **“PART X—RULES FOR APPLICATION OF DIVI-**
15 **DEND EXCLUSION AND RETAINED EARNINGS**
16 **BASIS ADJUSTMENTS.**

Sec. 281. Excludable portion of dividends.

Sec. 282. Retained earnings basis adjustments.

Sec. 283. Treatment of distributions after previous retained earnings basis adjustments.

Sec. 284. Special rules for credits and refunds.

Sec. 285. Special rules for foreign corporations and shareholders.

Sec. 286. Other special rules.

Sec. 287. Regulations.

17 **“SEC. 281. EXCLUDABLE PORTION OF DIVIDENDS.**

18 “(a) EXCLUDABLE PORTION.—For purposes of sec-
19 tion 116, the term ‘excludable portion’ means, with respect
20 to any dividend paid by a corporation in a calendar year,

1 an amount which bears the same ratio to such dividend
2 as the excludable dividend amount of such corporation for
3 the calendar year bears to the total amount of dividends
4 paid by such corporation in such calendar year.

5 “(b) EXCLUDABLE DIVIDEND AMOUNT.—For pur-
6 poses of this part and section 116—

7 “(1) IN GENERAL.—The term ‘excludable divi-
8 dend amount’ means, with respect to any corpora-
9 tion for any calendar year, the excess of—

10 “(A) the sum of—

11 “(i) the fully taxed earnings amount
12 for the preceding calendar year,

13 “(ii) the aggregate amount of divi-
14 dends received by the corporation during
15 such preceding year which are excluded
16 from gross income under section 116(a),
17 and

18 “(iii) the aggregate amount of in-
19 creases during such preceding year under
20 section 116(b) in the basis of stock held by
21 the corporation, over

22 “(B) the amount of applicable income tax
23 taken into account under subparagraph (A)(i).

24 “(2) CARRYOVER OF EXCESS OF EXCLUDABLE
25 DIVIDEND AMOUNT OVER EARNINGS AND PROFITS.—

1 The excludable dividend amount of a corporation for
2 any calendar year shall be increased by the excess
3 of—

4 “(A) the excludable dividend amount of
5 such corporation for the preceding calendar
6 year, over

7 “(B) the maximum amount which could
8 have been paid by the corporation as dividends
9 during such preceding calendar year.

10 “(c) FULLY TAXED EARNINGS AMOUNT.—

11 “(1) IN GENERAL.—The fully taxed earnings
12 amount for any calendar year is the amount of the
13 applicable income tax shown on applicable returns
14 for such year divided by the highest rate of tax spec-
15 ified in section 11.

16 “(2) INCREASE FOR PRIOR YEAR ASSESS-
17 MENTS.—The fully taxed earnings amount for any
18 calendar year shall be increased by the amount of
19 any applicable income tax (not previously taken into
20 account under paragraph (1)) which is assessed dur-
21 ing such year divided by the highest rate of tax spec-
22 ified in section 11.

23 “(3) LIMITATION TO AMOUNT PAID.—If an
24 amount described in paragraph (1) or (2) is paid
25 after the close of the calendar year in which such

1 amount would (but for this paragraph) be taken into
2 account, such amount shall be taken into account for
3 the calendar year in which paid.

4 “(4) HIGHEST RATE OF TAX.—For purposes of
5 this subsection, the highest rate of tax specified in
6 section 11 with respect to any applicable income tax
7 shall be such highest rate for the taxable year for
8 which (or by reference to which) such tax is deter-
9 mined.

10 “(d) DEFINITIONS.—For purposes of this part—

11 “(1) APPLICABLE INCOME TAX.—

12 “(A) IN GENERAL.—The term ‘applicable
13 income tax’ means the excess (if any) of—

14 “(i) the sum of the taxes imposed by
15 sections 11, 55, 511, 801, 831, 882, 1201,
16 1291 (without regard to section
17 1291(c)(1)(B)), and 1374, over

18 “(ii) the sum of the credits under part
19 IV of subchapter A (other than subpart C
20 and section 27(a)).

21 “(B) TRANSITIONAL RULES.—

22 “(i) IN GENERAL.—Such term shall
23 not include any tax imposed for any tax-
24 able year ending before April 1, 2001.

1 “(ii) TREATMENT OF MINIMUM TAX
2 CREDIT.—The applicable income tax shall
3 not be reduced by the credit under section
4 53 attributable (determined as if such
5 credit were used on a first-in first-out
6 basis) to taxable years ending before April
7 1, 2001.

8 “(iii) SECTION 1374.—The reference
9 to section 1374 in subparagraph (A)(i)
10 shall not apply to taxable years beginning
11 before January 1, 2003.

12 “(iv) OTHER TAXES INCLUDED.—The
13 taxes imposed by sections 531 and 541 (as
14 in effect before their repeal) shall be taken
15 into account under subparagraph (A)(i) for
16 taxable years ending after March 30, 2001,
17 and beginning before January 1, 2003.

18 “(2) APPLICABLE RETURN.—

19 “(A) IN GENERAL.—The term ‘applicable
20 return’ means, with respect to a calendar year,
21 any return of applicable income tax for a tax-
22 able year if the 15th day of the 8th month fol-
23 lowing the close of such taxable year occurs
24 during such calendar year.

1 “(B) FILING REQUIREMENT.—If a return
2 is filed after the close of the calendar year with
3 respect to which such return would (but for this
4 subparagraph) be treated as an applicable re-
5 turn under subparagraph (A), such return shall
6 be treated as an applicable return for the cal-
7 endar year in which filed.

8 **“SEC. 282. RETAINED EARNINGS BASIS ADJUSTMENTS.**

9 “(a) IN GENERAL.—If any portion of the excess de-
10 scribed in section 116(b) is allocated to a share of stock
11 in a corporation under subsection (b), the basis of such
12 share shall be increased by the amount so allocated.

13 “(b) ALLOCATION OF EXCESS.—

14 “(1) IN GENERAL.—A corporation may allocate
15 the excess described in section 116(b) for any cal-
16 endar year to shares of stock in the corporation at
17 1 or more times during the calendar year to the ex-
18 tent that cash in the amount of such excess, if dis-
19 tributed at the time of such allocation, would be a
20 dividend.

21 “(2) MANNER.—Except as provided in regula-
22 tions prescribed by the Secretary, any amount allo-
23 cated under paragraph (1) shall be allocated in the
24 same manner as if cash in such amount were actu-
25 ally distributed as dividends. No allocation shall be

1 effective before the date on which it is made by the
2 corporation.

3 “(3) EXCEPTION FOR CERTAIN PREFERRED
4 STOCK.—No amount may be allocated under this
5 subsection to stock described in section 1504(a)(4)
6 (determined without regard to subparagraph (A)
7 thereof).

8 “(c) EFFECT ON EARNINGS AND PROFITS.—Earn-
9 ings and profits of a corporation making an allocation
10 under subsection (b), and of a corporation receiving such
11 an allocation, shall be adjusted in the same manner as
12 if the allocation were treated as a dividend.

13 “(d) AUTHORITY TO ALLOW CARRYOVER OF
14 UNALLOCATED EXCESS EXCLUDABLE DIVIDEND
15 AMOUNT.—Notwithstanding section 281, the Secretary
16 may by regulation allow a corporation to increase the ex-
17 cludable dividend amount for any calendar year by the
18 amount of the excess described in section 116(b) for the
19 preceding calendar year which is not allocated under sub-
20 section (b).

21 **“SEC. 283. TREATMENT OF DISTRIBUTIONS AFTER PRE-**
22 **VIOUS RETAINED EARNINGS BASIS ADJUST-**
23 **MENTS.**

24 “(a) TREATMENT OF DISTRIBUTIONS.—

1 “(1) IN GENERAL.—If a corporation makes dis-
2 tributions described in section 301(a) with respect to
3 any class of stock in any calendar year which are
4 not excludable under section 116(a), such distribu-
5 tions shall not be treated as dividends (and para-
6 graphs (2) and (3) of section 301(c) shall apply to
7 such distributions) to the extent such distributions
8 do not exceed the corporation’s cumulative retained
9 earnings basis adjustment amount for such class as
10 of the beginning of such year. If such distributions
11 exceed such amount, this paragraph shall be applied
12 to a proportionate share of each such distribution.

13 “(2) SPECIAL RULES FOR RECHARACTERIZED
14 DIVIDENDS.—If any dividend (determined without
15 regard to this subsection) during any calendar year
16 with respect to any class of stock in a corporation
17 is treated as a distribution other than a dividend
18 under paragraph (1), such treatment shall be dis-
19 regarded for purposes of—

20 “(A) determining the excludable portion
21 under section 281 of dividends paid by the cor-
22 poration during the calendar year, and

23 “(B) determining whether any distribution
24 during the calendar year with respect to stock
25 in the corporation is treated as a dividend.

1 “(b) CUMULATIVE RETAINED EARNINGS BASIS AD-
2 JUSTMENT AMOUNT.—For purposes of this section, the
3 term ‘cumulative retained earnings basis adjustment
4 amount’ means, with respect to any class of stock for any
5 calendar year, the excess (if any) of—

6 “(1) the aggregate of the excess described in
7 section 116(b) allocated to shares of such class of
8 stock under section 282 for all preceding calendar
9 years, over

10 “(2) the aggregate amount of distributions to
11 which subsection (a)(1) applies with respect to such
12 class of stock for all preceding calendar years.

13 **“SEC. 284. SPECIAL RULES FOR CREDITS AND REFUNDS.**

14 “(a) IN GENERAL.—No overpayment of an applicable
15 income tax may be allowed as a credit or refund to the
16 extent that the overpayment exceeds the sum of—

17 “(1) the aggregate applicable income taxes for
18 the calendar year in which the credit or refund
19 would otherwise be allowed or made, and

20 “(2) an amount equal to the lesser of—

21 “(A) the product of the corporation’s ex-
22 cludable dividend amount for such calendar
23 year and the fraction the numerator of which is
24 the highest rate of tax specified in section 11
25 (within the meaning of section 281(c)(4)) and

1 the denominator of which is 1 minus such high-
2 est rate, or

3 “(B) the amount specified by the corpora-
4 tion for purposes of this paragraph.

5 “(b) ADJUSTMENTS TO EXCLUDABLE DIVIDEND
6 AMOUNTS RESULTING FROM CREDITS AND REFUNDS.—

7 If subsection (a) applies to any credit or refund which is
8 allowed or made in a calendar year—

9 “(1) the applicable income taxes described in
10 subsection (a)(1) otherwise taken into account under
11 section 281 for determining the excludable dividend
12 amount for the succeeding calendar year shall be re-
13 duced (but not below zero) by the amount of the
14 credit or refund, and

15 “(2) the excludable dividend amount for the cal-
16 endar year shall be reduced by the excess of—

17 “(A) the amount determined under sub-
18 section (a)(2) divided by the highest rate of tax
19 specified in section 11, over

20 “(B) the amount determined under sub-
21 section (a)(2).

22 “(c) DISALLOWED OVERPAYMENT NOT LOST.—

23 Nothing in subsection (a) shall be construed to reduce the
24 amount of any overpayment for which credit or refund is
25 not allowed by reason of subsection (a), and such overpay-

1 ment shall continue to be taken into account in applying
2 subsection (a) for succeeding calendar years until a credit
3 or refund is allowed or made.

4 “(d) EXCEPTION FOR FOREIGN TAX CREDIT.—This
5 section shall not apply to any overpayment to the extent
6 that such overpayment is attributable to the credit allowed
7 under section 27(a).

8 “(e) DENIAL OF INTEREST.—No interest shall be al-
9 lowed on any overpayment during the period that credit
10 or refund of such overpayment is not allowed by reason
11 of this section.

12 **“SEC. 285. SPECIAL RULES FOR FOREIGN CORPORATIONS**
13 **AND SHAREHOLDERS.**

14 “(a) COMPUTATION OF EXCLUDABLE DIVIDEND
15 AMOUNTS OF FOREIGN CORPORATIONS.—

16 “(1) REDUCTION IN EXCLUDABLE DIVIDEND
17 AMOUNT FOR CERTAIN TAXES.—The reduction
18 under section 281(b)(1)(B) (without regard to this
19 subparagraph) shall be increased by the sum of—

20 “(A) the taxes imposed by section 884 (re-
21 lating to branch profits tax), and

22 “(B) so much of the taxes imposed by sec-
23 tion 881 as are attributable to dividends which
24 would (but for subsection (b)) be excludable
25 under section 116 or are attributable to dis-

1 tributions which are described in section
2 283(a).

3 “(2) TREATMENT OF DISALLOWED EXCLUSIONS
4 AND ADJUSTMENTS.—Notwithstanding subsection
5 (b)—

6 “(A) the excludable dividend amount of a
7 foreign corporation for a calendar year shall be
8 increased by—

9 “(i) the dividends received by the cor-
10 poration which (but for subsection (b))
11 would be excludable under section 116(a),
12 and

13 “(ii) the distributions received by such
14 corporation during such year which are de-
15 scribed in section 283(a), and

16 “(B) the earnings and profits of a foreign
17 corporation—

18 “(i) shall be increased by the amount
19 described in subparagraph (A)(ii), and

20 “(ii) shall not be increased by any ex-
21 cess described in section 116(b) allocated
22 to such corporation for which an increase
23 in basis is not allowed by reason of sub-
24 section (b)(2).

1 “(b) TAXATION OF FOREIGN SHAREHOLDERS.—In
2 the case of a shareholder who is a nonresident alien indi-
3 vidual or a foreign corporation—

4 “(1) no dividends shall be excludable under sec-
5 tion 116(a),

6 “(2) there shall be no increase in basis for any
7 excess described in section 116(b) allocated to such
8 individual or corporation under section 282, and

9 “(3) any distribution described in section 283
10 shall be treated as a dividend for purposes of sec-
11 tions 871 and 881 and chapter 3.

12 “(c) RULES RELATING TO FOREIGN TAX CREDIT.—

13 “(1) IN GENERAL.—No credit shall be allowed
14 under section 901 for any taxes paid or accrued (or
15 deemed paid under section 902 or 960) with respect
16 to any dividend excludable under section 116 and
17 any distribution described in section 283(a).

18 “(2) EXCLUDABLE DIVIDEND AMOUNT.—The
19 excludable dividend amount of a corporation for any
20 calendar year shall be determined without regard to
21 a reduction in the credit allowed by section 27(a) on
22 an applicable return for a prior calendar year.

23 **“SEC. 286. OTHER SPECIAL RULES.**

24 “(a) REDEMPTIONS.—If a corporation makes a dis-
25 tribution to a shareholder during any calendar year with

1 respect to its stock and section 301 does not apply to such
2 distribution, the excludable dividend amount for the cal-
3 endar year, and the cumulative retained earnings basis ad-
4 justment amount as of the beginning of the calendar year
5 in which the distribution is made, shall be reduced by the
6 ratable share of such amounts attributable to the stock
7 so redeemed.

8 “(b) COORDINATION WITH SECTION 246(C).—

9 “(1) HOLDING PERIOD REQUIREMENTS.—If a
10 shareholder disposes of any share of stock before the
11 holding period requirements of section 246(c) are
12 met—

13 “(A) the basis of such share shall be re-
14 duced by the amount of dividends received with
15 respect to such share which are excludable
16 under section 116(a), and

17 “(B) there shall be no increase in basis for
18 any excess described in section 116(b) allocated
19 to the shareholder of such stock under section
20 282.

21 “(2) RELATED PAYMENTS.—No deduction shall
22 be allowed under this chapter for any related pay-
23 ments described in section 246(c)(1)(B) with respect
24 to any dividend excludable under section 116(a) or
25 basis increase under section 116(b) with respect to

1 any share of stock to the extent that such payments
2 do not exceed the amount of such dividend or basis
3 increase.

4 “(3) TREATMENT OF DISALLOWED EXCLUSIONS
5 AND ADJUSTMENTS.—The excludable dividend
6 amount of any corporation for a calendar year, and
7 its earnings and profits, shall not be increased by—

8 “(A) the dividends received by the corpora-
9 tion which are excludable under section 116(a)
10 and which resulted in a basis reduction under
11 paragraph (1)(A), and

12 “(B) the aggregate increases in basis
13 which (but for paragraph (1)(B)) would be
14 made in stock held by the corporation.

15 “(c) TREATMENT OF REGULATED INVESTMENT COM-
16 PANIES AND REAL ESTATE INVESTMENT TRUSTS.—

17 “(1) IN GENERAL.—Except as provided in regu-
18 lations, the excludable dividend amount of a regu-
19 lated investment company or real estate investment
20 trust shall be zero.

21 “(2) CROSS REFERENCE.—

**“For special rules relating to application of this
part to regulated investment companies and real es-
tate investment trusts, see section 852(g).**

22 “(d) EXCLUSION AND BASIS ALLOCATION REDUCED
23 WHERE PORTFOLIO STOCK HELD BY CORPORATION IS
24 DEBT-FINANCED.—

1 “(1) TREATMENT OF EXCLUDABLE DIVI-
2 DEND.—In the case of any debt-financed portfolio
3 stock (within the meaning of section 246A), the
4 amount excluded under section 116(a) with respect
5 to any dividend received with respect to such stock
6 shall be an amount equal to the product of—

7 “(A) the amount which would be excluded
8 under section 116(a) without regard to this
9 paragraph, and

10 “(B) 100 percent minus the average in-
11 debtedness percentage (within the meaning of
12 section 246A(d)).

13 “(2) TREATMENT OF BASIS INCREASE.—In the
14 case of any debt-financed portfolio stock (within the
15 meaning of section 246A) with respect to which
16 there is an increase in basis under section 116(b)
17 during any taxable year, the gross income of the tax-
18 payer shall be increased by an amount equal to the
19 product of—

20 “(A) the amount of the increase under sec-
21 tion 116(b), and

22 “(B) the average indebtedness percentage
23 (within the meaning of section 246A(d)).

24 “(3) LIMITATION.—The aggregate amount of
25 reductions under paragraph (1) and increases in

1 gross income under paragraph (2) with respect to
2 any debt-financed portfolio stock shall not exceed the
3 amount of interest deduction (including any deduct-
4 ible short sale expense) allocable to such stock.

5 “(4) TREATMENT OF INCREASE IN GROSS IN-
6 COME.—The excludable dividend amount of a cor-
7 poration for a calendar year shall not be increased
8 by reason of any increase in gross income under
9 paragraph (2).

10 “(5) EXCEPTION.—This subsection shall not
11 apply to any dividend described in paragraph (1) or
12 (2) of section 246A(b).

13 “(e) COOPERATIVES.—In the case of a cooperative to
14 which subchapter T applies—

15 “(1) the excludable dividend amount of such co-
16 operative shall be allocated for purposes of section
17 116 and this part between shares of such coopera-
18 tive held by patrons and shares held by other per-
19 sons in such manner as the Secretary shall prescribe
20 by regulations, and

21 “(2) no deduction shall be allowed to the coop-
22 erative under this chapter for any dividend paid to
23 a patron which is excludable under section 116(a) or
24 for any distribution described in section 283(a)

1 which reduced the basis of stock held by the cooper-
2 ative under section 301(c)(2).

3 “(f) ESOP STOCK.—Any dividend allowed as a de-
4 duction under section 404(k) shall not be treated as a divi-
5 dend for purposes of section 116 and this part, and any
6 stock with respect to which such a dividend may be paid
7 shall not be taken into account in making any allocation
8 under 282 or any distribution described in section 283(a).

9 **“SEC. 287. REGULATIONS.**

10 “The Secretary shall prescribe such regulations as
11 may be appropriate to carry out section 116 and this part,
12 including regulations—

13 “(1) providing for the treatment of options and
14 convertible debt as stock, including modification of
15 the attribution rules under section 318(a)(4),

16 “(2) providing for the allocation of the exclud-
17 able dividend amount and the cumulative retained
18 earnings basis adjustment amount in the case of
19 transactions described in section 312(h),

20 “(3) waiving the application of section
21 246(c)(4) for purposes of sections 286(b) and
22 1059(g),

23 “(4) modifying the consolidated return regula-
24 tions to the extent necessary or appropriate to apply
25 the provisions of this part, including regulations that

1 accelerate the inclusion in the excludable dividend
2 amount of a higher-tier member with respect to—

3 “(A) activities of lower-tier members of the
4 group,

5 “(B) dividends excludable under section
6 116(a) received from such lower-tier members,
7 and

8 “(C) increases in basis allocated under sec-
9 tion 282 to stock in such lower-tier members,

10 “(5) providing for the application of section 116
11 and this part in the case of pass-thru entities, in-
12 cluding appropriate adjustments to basis, and

13 “(6) as are necessary to further the purposes of
14 section 116 and this part and to prevent the cir-
15 cumvention of such purposes.

16 Any regulations under paragraph (4) may be effective as
17 of the effective date of this part.”

18 (b) REPORTING OF EXCLUDABLE DIVIDENDS AND
19 RETAINED EARNINGS BASIS ADJUSTMENTS.—

20 (1) IN GENERAL.—Section 6042(a) (relating to
21 returns regarding payments of dividends and cor-
22 porate earnings and profits) is amended to read as
23 follows:

24 “(a) REQUIREMENT OF REPORTING.—

25 “(1) IN GENERAL.—Every person—

1 “(A) who makes payments of dividends ag-
2 gregating \$10 or more to any other person dur-
3 ing any calendar year,

4 “(B) who allocates under section 282 in-
5 creases in basis of stock in a corporation aggre-
6 gating \$10 or more to any other person during
7 any calendar year,

8 “(C) who makes distributions described in
9 section 283(a) aggregating \$10 or more to any
10 other person during any calendar year, or

11 “(D) who receives such payments of divi-
12 dends, allocations of increases in basis, or dis-
13 tributions as a nominee and who makes pay-
14 ments or allocates increases aggregating \$10 or
15 more during any calendar year to any other
16 person with respect to the dividends, alloca-
17 tions, or distributions received,

18 shall make a return at the time and in the manner
19 prescribed by the Secretary, setting forth the infor-
20 mation described in paragraph (3).

21 “(2) RETURNS REQUIRED BY SECRETARY.—

22 Every person who makes payments of dividends, al-
23 locations under section 282, or distributions de-
24 scribed in section 283(a) to which paragraph (1)
25 does not apply shall, when required by the Secretary,

1 make a return setting forth the information de-
2 scribed in paragraph (3).

3 “(3) INFORMATION REPORTED.—Information
4 described in this paragraph includes—

5 “(A) the aggregate amount of dividends,
6 including the portion of such amount excludable
7 from gross income under section 116(a),

8 “(B) the amount of each allocation of basis
9 under section 282 with respect to each share of
10 stock and the date of such increase,

11 “(C) the amount of each distribution de-
12 scribed in section 283(a), including the portion
13 of such amount to which paragraph (2) or (3)
14 of section 301(e) applies and the date of such
15 distribution, and

16 “(D) such other information as the Sec-
17 retary may require.

18 In the case of a nominee described in paragraph
19 (1)(D), this paragraph shall apply with respect to
20 the payments and allocations made by the nominee.”

21 (2) APPLICATION TO FOREIGN PERSONS.—Sec-
22 tion 6042 is amended by adding at the end the fol-
23 lowing new subsection:

24 “(e) APPLICATION TO FOREIGN PERSONS.—The Sec-
25 retary may provide for the application of this section to

1 payments, allocations, and distributions made by or to a
2 foreign person to the extent necessary to carry out the
3 provisions of section 116 and part X of subchapter B of
4 chapter 1.”

5 (3) CONFORMING AMENDMENTS.—

6 (A) Section 6042(b)(3) is amended by
7 striking “or (B)” and inserting “or (D)”.

8 (B) Section 6042(c)(2) is amended to read
9 as follows:

10 “(2) the information described in subsection
11 (a)(3) required to be shown on the return.”

12 (c) AMENDMENTS TO OTHER SECTIONS.—

13 (1) MINIMUM TAX.—Clause (i) of section
14 56(g)(4)(B) is amended by striking “or under sec-
15 tion 114” and inserting “, section 114, or section
16 116”.

17 (2) COORDINATION WITH DIVIDEND RECEIVED
18 DEDUCTIONS.—

19 (A) Section 246 is amended by adding at
20 the end the following new subsection:

21 “(f) COORDINATION WITH DIVIDEND EXCLUSION.—

22 No deduction shall be allowed under section 243, 244, or
23 245 with respect to the amount of any dividend excluded
24 from gross income under section 116 or would be so ex-
25 cluded but for sections 285(b)(1) and 286(d).”

1 (B) Section 243 is amended by adding at
2 the end the following new subsection:

3 “(f) TERMINATION.—Paragraph (1) of subsection (a)
4 shall not apply to any dividend—

5 “(1) paid from earnings and profits accumu-
6 lated in taxable years ending after April 1, 2001,

7 “(2) made with respect to stock issued after
8 February 2, 2003, or

9 “(3) received by a corporation after December
10 31, 2005.”

11 (3) CARRYOVERS IN CERTAIN CORPORATION AC-
12 QUISTIONS.—Section 381(c) is amended by adding
13 at the end the following new paragraph:

14 “(27) EDA AND CREBAA.—The acquiring
15 corporation shall take into account (to the extent
16 proper to carry out the purposes of this section, sec-
17 tion 116, and part X of subchapter B, and under
18 such regulation as may be prescribed by the Sec-
19 retary) the excludable dividend amount and the cu-
20 mulative retained earnings basis adjustment amount
21 in respect of the distributor or transferor.”

22 (4) TRUSTS AND ESTATES.—Subsection (a) of
23 section 643 is amended—

1 (A) by redesignating paragraph (7) as
2 paragraph (8) and by inserting after paragraph
3 (6) the following new paragraph:

4 “(7) DIVIDENDS, ETC.—There shall be included
5 the amount of any dividends excluded from gross in-
6 come under section 116 and the amount of any dis-
7 tribution described in section 283.”, and

8 (B) by striking “and (6)” in the last sen-
9 tence and inserting “, (6), and (7)”.

10 (5) PARTNERSHIPS.—

11 (A) Paragraph (5) of section 702(a) is
12 amended to read as follows:

13 “(5) dividends with respect to which there is an
14 exclusion under section 116 or a deduction under
15 part VIII of subchapter B,”.

16 (B) Section 705(a)(1) is amended by strik-
17 ing “and” at the end of subparagraph (B), by
18 striking the semicolon at the end of subpara-
19 graph (C) and inserting “, and”, and by adding
20 at the end the following new subparagraph:

21 “(D) increases in basis under section
22 116(b) allocated to the partnership;”.

23 (6) EXTRAORDINARY DIVIDENDS.—

24 (A) IN GENERAL.—Section 1059 is amend-
25 ed by redesignating subsection (g) as subsection

1 (h) and by inserting after subsection (f) the fol-
2 lowing new subsection:

3 “(g) TREATMENT OF EXCLUDABLE DIVIDENDS AND
4 RETAINED EARNINGS BASIS ADJUSTMENTS AS EXTRAOR-
5 DINARY DIVIDENDS.—

6 “(1) IN GENERAL.—For purposes of this sec-
7 tion, any dividend excludable under section 116(a)
8 or increase in basis under section 116(b) shall be
9 treated as an extraordinary dividend, except that
10 this section shall be applied by substituting ‘1 year
11 (or such other period as the Secretary may pre-
12 scribe)’ for ‘2 years’ each place it appears.

13 “(2) TREATMENT OF DEEMED EXTRAORDINARY
14 DIVIDENDS.—The excludable dividend amount of
15 any corporation for a calendar year, and its earnings
16 and profits, shall not be increased by—

17 “(A) the dividends received by the corpora-
18 tion which are treated as extraordinary divi-
19 dends by reason of paragraph (1), and

20 “(B) the aggregate increases in basis
21 under section 116(b) which are so treated.

22 “(3) REGULATIONS.—The Secretary may by
23 regulation provide for exceptions to the application
24 of paragraph (1).”

1 (B) Paragraph (3) of section 1059(d) is
2 amended by inserting “section 1223(11) shall
3 not apply and” after “subsection (a),”.

4 (C)(i) Section 1059 is amended by striking
5 “corporation” each place it appears in sub-
6 section (a) and inserting “taxpayer”.

7 (ii) The section heading for section 1059 is
8 amended by striking “**CORPORATE**” and by in-
9 serting “**AND EXCLUDABLE**” before “**DIVI-**
10 **DENDS**”.

11 (iii) The item relating to section 1059 in
12 the table of sections for part IV of subchapter
13 O of chapter 1 is amended by striking “cor-
14 porate” and by inserting “and excludable” be-
15 fore “dividends”.

16 (7) PRIVATE FOUNDATIONS.—Section 4940(c)
17 is amended by adding at the end the following new
18 paragraph:

19 “(6) COORDINATION WITH DIVIDEND EXCLU-
20 SION.—For purposes of this section, gross invest-
21 ment income shall not include—

22 “(A) a dividend to the extent excluded
23 from gross income under section 116(a), and

24 “(B) a distribution described in section
25 283.”

1 (d) CONFORMING AMENDMENTS.—

2 (1)(A) Part X of subchapter B of chapter 1, as
3 in effect on the day before the date of the enactment
4 of this Act, is hereby moved after part XI of such
5 subchapter B and redesignated as part XII.

6 (B) Section 281, as so in effect, is redesignated
7 as section 296.

8 (C) The table of sections for such part XII, as
9 so designated, is amended by striking “Sec. 281”
10 and inserting “Sec. 296.

11 (D) The table of parts for subchapter B of
12 chapter 1 is amended by striking the items relating
13 to parts X and XI and inserting the following new
14 items:

“Part X. Rules for application of dividend exclusion and retained
earnings basis adjustments.

“Part XI. Special rules relating to corporate preference items.

“Part XII. Terminal railroad corporations and their share-
holders.”

15 (2) Subsection (f) of section 301 is amended by
16 adding at the end the following new paragraph:

17 “(4) For exclusion from gross income of certain
18 dividends, see section 116.”

19 **SEC. 203. TREATMENT OF REGULATED INVESTMENT COM-**
20 **PANIES AND REAL ESTATE INVESTMENT**
21 **TRUSTS.**

22 (a) IN GENERAL.—Section 852 is amended by adding
23 at the end the following new subsection:

1 “(g) SPECIAL RULES RELATING TO SECTION 116 AND
2 PART X OF SUBCHAPTER B.—

3 “(1) EXCLUDABLE PORTION.—

4 “(A) IN GENERAL.—For purposes of sec-
5 tion 116(a), the excludable portion of any divi-
6 dend paid by any qualified investment entity
7 shall be the amount so designated by such enti-
8 ty in a written notice mailed to its shareholders
9 not later than 60 days after the close of its tax-
10 able year in which such dividend is paid.

11 “(B) LIMITATION.—If the aggregate
12 amount so designated with respect to a taxable
13 year (including dividends paid after the close of
14 the taxable year as described in section 855) ex-
15 ceeds the aggregate amount of dividends re-
16 ceived by such entity during such year which
17 are excludable from gross income under section
18 116(a), then the amount of a dividend other-
19 wise excludable by reason of a designation
20 under subparagraph (A) shall be reduced by an
21 amount which bears the same ratio to the
22 amount otherwise excludable as such excess
23 bears to the total amount designated under sub-
24 paragraph (A).

1 “(C) TREATMENT OF CAPITAL GAIN AND
2 EXEMPT-INTEREST DIVIDENDS.—Any amount
3 designated under subparagraph (A) as exclud-
4 able under section 116 may not be treated as
5 a capital gain dividend or an exempt-interest
6 dividend.

7 “(D) COORDINATION WITH SECTION 853.—
8 The election under section 853 shall not apply
9 to dividends excludable under section 116 and
10 distributions described in section 283(a) re-
11 ceived by a qualified investment entity.

12 “(2) RETAINED EARNINGS BASIS ADJUST-
13 MENTS.—

14 “(A) IN GENERAL.—A qualified investment
15 entity may allocate any increase in basis allo-
16 cated to the entity under section 282 to shares
17 of stock in the entity at 1 or more times during
18 the taxable year in the manner and the time
19 prescribed in paragraphs (2) and (3) of section
20 282(b).

21 “(B) DESIGNATION.—For purposes of sec-
22 tion 116(b), the increase in basis allocated to
23 any share of stock in the entity shall be the
24 amount so designated by such entity in a writ-
25 ten notice mailed to its shareholders not later

1 than 60 days after the close of its taxable year
2 in which such allocation is made.

3 “(C) LIMITATION.—Rules similar to the
4 rules of paragraph (1)(B) shall apply to
5 amounts allocated under this paragraph.

6 “(D) SHAREHOLDER TREATMENT OF
7 AMOUNTS DESIGNATED.—Shareholders of such
8 entity who receive an allocation under this
9 paragraph from such entity shall take into ac-
10 count such allocation as if it were an allocation
11 under section 282.

12 “(E) EARNINGS AND PROFITS.—Earnings
13 and profits of the entity making such an alloca-
14 tion shall be adjusted in the same manner as
15 provided in section 282(c).

16 “(3) CERTAIN DISTRIBUTIONS AFTER PREVIOUS
17 RETAINED EARNINGS BASIS ADJUSTMENTS.—

18 “(A) IN GENERAL.—If any qualified in-
19 vestment entity receives during any taxable year
20 distributions described in section 283(a) which
21 reduced the basis of stock held by such entity
22 under section 301(c)(2), the entity may des-
23 ignate any distributions described in section
24 301(a) made by such entity in such taxable
25 year which are not excludable under section

1 116(a) (after the application of paragraph (1))
2 as distributions described in section 283(a).
3 Such designations shall be made in a written
4 notice mailed to its shareholders not later than
5 60 days after the close of its taxable year in
6 which such distribution is made.

7 “(B) LIMITATION.—If the aggregate
8 amount so designated with respect to a taxable
9 year (including distributions paid after the close
10 of the taxable year as provided in section
11 855(e)) exceeds the aggregate distributions de-
12 scribed in section 283(a) which reduced the
13 basis of stock held by such entity under section
14 301(c)(2) for such taxable year, then the
15 amount of a distribution otherwise treated as a
16 distribution described in section 283(a) by rea-
17 son of a designation under subparagraph (A)
18 shall be reduced by an amount which bears the
19 same ratio to the amount otherwise so treated
20 as such excess bears to the total amount des-
21 ignated under subparagraph (A).

22 “(C) SHAREHOLDER TREATMENT OF
23 AMOUNTS DESIGNATED.—Shareholders of such
24 entity who receive a distribution from such enti-
25 ty which is designated under this paragraph

1 shall treat such distribution as a distribution
2 described in section 283(a).

“(D) TREATMENT OF CAPITAL GAIN AND
EXEMPT-INTEREST DIVIDENDS.—Any distribu-
tion designated under subparagraph (A) may
not be treated as a capital gain dividend or an
exempt-interest dividend.

8 “(E) ADJUSTMENTS.—No adjustment shall
9 be made in the earnings and profits of a quali-
10 fied investment entity with respect to a dis-
11 tribution by such entity which is designated
12 under subparagraph (A).

13 “(4) COORDINATION WITH DIVIDENDS PAID DE-
14 DUCTION.—No allocation or distribution designated
15 under paragraph (2) or (3) shall be treated as a div-
16 idend for purposes of section 561.

17 “(5) DEFINITIONS.—For purposes of this
18 subsection—

19 “(A) QUALIFIED INVESTMENT ENTITY.—
20 The term ‘qualified investment entity’ means—

21 “(i) a regulated investment company,
22 and

23 “(ii) a real estate investment trust.

1 “(B) EXEMPT-INTEREST DIVIDEND.—The
2 term ‘exempt-interest dividend’ has the mean-
3 ing given to such term by subsection (b)(5).”

4 (b) OTHER RULES RELATING TO REGULATED IN-
5 VESTMENT COMPANIES.—

6 (1) DISTRIBUTION REQUIREMENTS.—

7 (A) Clause (i) of section 852(a)(1)(B) is
8 amended by inserting “and its dividend income
9 excludable under section 116(a),” before
10 “over”.

11 (B) Section 852(a) is amended by striking
12 “and” at the end of paragraph (1), by redesign-
13 ating paragraph (2) as paragraph (3), and by
14 inserting after paragraph (1) the following new
15 paragraph:

16 “(2) 90 percent of the distributions described in
17 section 283(a)—

18 “(A) which are received by such company
19 during the taxable year, and

20 “(B) which reduce under section 301(c)(2)
21 the basis of stock held by such company,
22 are distributed during such year under subsection
23 (g)(3)(A), and”.

24 (C) Section 855 is amended by adding at
25 the end the following new subsection:

1 “(e) DISTRIBUTION OF PREVIOUSLY RETAINED
2 EARNINGS BASIS ADJUSTMENTS.—Rules similar to the
3 rules of the preceding provisions of this section shall apply
4 to distributions described in section 852(g)(3)(A).”

5 (2) TAXATION OF ENTITY AND SHARE-
6 HOLDERS.—

7 (A) The material following paragraph (3)
8 of section 851(b) is amended—

9 (i) by inserting “, dividends excludable
10 from gross income under section 116(a),
11 and distributions described in section
12 283(a) which reduce the basis of stock
13 under section 301(c)(2)” after “103(a)” in
14 the third sentence, and

15 (ii) by adding at the end the following
16 new sentence: “For purposes of paragraph
17 (2), distributions described in section
18 283(a) which reduce the basis of stock
19 under section 301(c)(2) shall be treated as
20 dividends.”

21 (B) Section 852(b)(2)(D) is amended by
22 striking “and exempt-interest dividends” and
23 inserting “, exempt-interest dividends, and any
24 dividends excludable under section 116(a)”.

1 (C) Subparagraph (B) of section 852(b)(4)
2 is amended to read as follows:

3 “(B) LOSS ATTRIBUTABLE TO EXEMPT
4 DIVIDENDS.—If—

5 “(i) a shareholder of a regulated in-
6 vestment company receives an exempt-in-
7 terest dividend, a dividend excludable
8 under section 116(a), or an allocation
9 under subsection (g)(2), with respect to
10 any share, and

11 “(ii) such share is held by the tax-
12 payer for 6 months or less,

13 then any loss on the sale or exchange of such
14 share shall, to the extent of the sum of the
15 amounts of such dividends and allocations, be
16 disallowed.”

17 (D) Paragraph (3) of section 4982(c) is
18 amended by striking “and” at the end of sub-
19 paragraph (A), by striking the period at the
20 end of subparagraph (B) and inserting “, and”,
21 and by adding at the end the following new sub-
22 paragraph:

23 “(C) any dividend excludable from gross
24 income under section 116(a).”

1 (c) OTHER RULES RELATING TO REAL ESTATE IN-
2 VESTMENT TRUSTS.—

3 (1) DISTRIBUTION REQUIREMENTS.—

4 (A) Subparagraph (A) of section 857(a)(1)
5 is amended by striking “and” at the end of
6 clause (i), by striking “minus” at the end of
7 clause (ii), and by inserting at the end the fol-
8 lowing new clause:

9 “‘(iii) 90 percent of its dividend in-
10 come excludable under section 116(a);
11 minus”

12 (B) Subsection (a) of section 857 is
13 amended by redesignating paragraph (2) as
14 paragraph (3) and by inserting after paragraph
15 (1) the following new paragraph:

16 “(2) 90 percent of the distributions described in
17 section 283(a)—

18 “(A) which are received by such trust dur-
19 ing the taxable year, and

20 “(B) which reduce under section 301(c)(2)
21 the basis of stock held by such trust,
22 are distributed during such year under subsection
23 (g)(3)(A); and”.

24 (C) Section 858 is amended by adding at
25 the end the following new subsection:

1 “(d) DISTRIBUTION OF PREVIOUSLY RETAINED
2 EARNINGS BASIS ADJUSTMENTS.—Rules similar to the
3 rules of the preceding provisions of this section shall apply
4 to distributions described in section 852(g)(3).”

5 (2) TAXATION OF ENTITY AND SHARE-
6 HOLDERS.—

7 (A)(i) Section 856(c)(2) is amended—

8 (I) by inserting “(including dividends
9 excludable from gross income under section
10 116(a)) and distributions described in sec-
11 tion 283(a) which reduce the basis of stock
12 under section 301(c)(2)” after “dividends”
13 in subparagraph (A), and

14 (II) by inserting “(including tax-ex-
15 empt interest)” after “interest” in sub-
16 paragraph (B).

17 (ii) Section 856(c) is amended by adding
18 at the end the following new paragraph:

19 “(8) GROSS INCOME TESTS.—For purposes of
20 paragraphs (2) and (3), gross income shall be treat-
21 ed as including tax-exempt interest, dividends ex-
22 cludable from gross income under section 116(a),
23 and distributions described in section 283(a) which
24 reduce the basis of stock under section 301(c)(2).”

1 (B) Section 857(b)(2)(B) is amended by
2 inserting “ or any dividends paid which are ex-
3 cludable under section 116(a)” after “subpara-
4 graph (D)”.

5 (C) Section 857(b) is amended by adding
6 at the end the following new paragraph:

7 “(10) LOSS ATTRIBUTABLE TO EXEMPT DIVI-
8 DENDS.—If—

9 “(A) a shareholder of a real estate invest-
10 ment trust receives a dividend excludable under
11 section 116(a) or an allocation under section
12 852(g)(2) with respect to any share, and

13 “(B) such share is held by the taxpayer for
14 6 months or less,
15 then any loss on the sale or exchange of such share
16 shall, to the extent of the sum of the amounts of
17 such dividends and allocations, be disallowed.”

18 (D) Subsection (g) of section 857 is
19 amended to read as follows:

20 “(g) CROSS REFERENCES.—

21 “(1) For provisions relating to excise tax based
22 on certain real estate investment trust taxable in-
23 come not distributed during the taxable year, see
24 section 4981.

1 “(2) For special rules relating to application of
2 dividend exclusion and retained earnings basis ad-
3 justments, see section 852(g).”

4 (E) Paragraph (1) of section 4981(c) is
5 amended by striking “and” at the end of sub-
6 paragraph (A), by striking the period at the
7 end of subparagraph (B) and inserting “, and”,
8 and by adding at the end the following new sub-
9 paragraph:

10 “(C) any dividend excludable from gross
11 income under section 116(a).”

12 **SEC. 204. TREATMENT OF INSURANCE COMPANIES.**

13 (a) LIFE INSURANCE COMPANIES.—

14 (1) Section 803 is amended by adding at the
15 end the following new subsection:

16 “(c) SPECIAL RULES FOR EXCLUDABLE DIVIDENDS
17 AND RETAINED EARNINGS BASIS ADJUSTMENTS.—

18 “(1) IN GENERAL.—The exclusion under sec-
19 tion 116(a) with respect to any dividend received by
20 a life insurance company shall only apply to such
21 company’s share (as determined under section 812)
22 of such dividend.

23 “(2) RETAINED EARNINGS BASIS ADJUST-
24 MENTS.—In the case of any increase in basis under

1 section 116(b) allocated under section 282 to stock
2 held by a life insurance company—

3 “(A) the life insurance company’s and pol-
4 icyholders’ shares of such allocation shall be de-
5 termined in accordance with section 812 in the
6 same manner as if it were a dividend, and

7 “(B) life insurance company gross income
8 of such company shall be increased by the pol-
9 icyholders’ share of such allocation.

10 “(3) RULES FOR SEGREGATED ASSET AC-
11 COUNTS.—In the case of stock held in a segregated
12 asset account (within the meaning of section 817),
13 this subsection shall be applied as if the policy-
14 holders’ share of the excludable portion of any divi-
15 dend, or any increase in basis under section 116(b),
16 with respect to such stock were 100 percent.

17 “(4) COMPUTATION OF EXCLUDABLE DIVIDEND
18 AMOUNT.—In the case of a life insurance company,
19 the increase under clause (ii) or (iii) of section
20 281(b)(1)(A) in the company’s excludable dividend
21 amount shall be limited to the company’s share (as
22 determined under section 812) of the dividends or
23 increases in basis described in either such clause.”

1 (2) Section 812(d)(1)(A) is amended by insert-
2 ing “(including dividends excludable under section
3 116(a))” after “dividends”.

4 (3) Section 815(c)(2)(A)(iii) is amended by
5 adding “,the amount of dividends excludable under
6 section 116(a) (as modified by section 803(c)(1)),
7 and the amount of basis increase under section
8 116(b) (as modified by section 803(c)(2))” after
9 “section 103”.

10 (b) OTHER INSURANCE COMPANIES.—

11 (1) Section 832(b)(5)(B) is amended by strik-
12 ing “and” at the end of clause (ii), by striking the
13 period at the end of clause (iii) and inserting “,
14 and”, and by adding after clause (iii) the following
15 new clause:

16 “(iv) any dividend excludable under
17 section 116(a) which is received during
18 such taxable year and any increase in basis
19 under section 116(b) which is allocated
20 under section 282 to such company during
21 such taxable year.”

22 (2) Section 832(c) is amended by striking
23 “and” at the end of paragraph (12), by striking the
24 period at the end of paragraph (13) and inserting “;

1 and”, and by adding at the end the following new
2 paragraph:

3 “(14) the amount of dividends received during
4 the taxable year which are excluded from gross in-
5 come under section 116(a).”

6 (3) Section 833(b)(3)(E) is amended—

7 (A) by striking “and” at the end of clause
8 (i), by striking the period at the end of clause
9 (ii) and inserting “, and”, and by inserting
10 after clause (ii) the following new clause:

11 “(iii) the aggregate amount excluded
12 for the taxable year under section
13 116(a).”, and

14 (B) by adding at the end the following:

15 “The amount determined under clause (iii)
16 shall be reduced by the amount of any decrease
17 in such deductions for the taxable year by rea-
18 son of section 832(b)(5)(B) to the extent such
19 decrease is attributable to the exclusion under
20 section 116(a).”

21 (4) Section 834(c) is amended by adding at the
22 end the following new paragraph:

23 “(10) EXCLUDABLE DIVIDENDS.—The amount
24 of dividends received during the taxable year which

1 are excluded from gross income under section
2 116(a).”

3 **SEC. 205. TREATMENT OF S CORPORATIONS.**

4 (a) BASIS ADJUSTMENTS RELATING TO DIVI-
5 DENDS.—Section 1367(a)(1) is amended by striking
6 “and” at the end of subparagraph (B), by striking the
7 period at the end of subparagraph (C) and inserting “,
8 and”, and by adding at the end the following new subpara-
9 graph:

10 “(D) increases in basis under section
11 116(b) allocated to the S corporation.”.

12 (b) APPLICATION OF SECTION 116 AND PART X OF
13 SUBCHAPTER B TO S CORPORATIONS.—

14 (1) IN GENERAL.—Section 1368 is amended by
15 adding at the end the following new subsection:

16 “(f) COORDINATION WITH DIVIDEND EXCLUSION
17 AND RETAINED EARNINGS BASIS ADJUSTMENTS.—

18 “(1) DETERMINATION OF EXCLUDED DIVI-
19 DENDS AMOUNT.—

20 “(A) IN GENERAL.—Clauses (ii) and (iii)
21 of section 281(b)(1)(A) shall not apply to
22 amounts received or allocated in a taxable year
23 for which the corporation is an S corporation.

1 “(B) CROSS REFERENCE.—

“**For treatment of taxes imposed by section 1374,
see section 281(d)(1).**”

2 “(2) DISTRIBUTIONS.—Subject to regulations
3 prescribed by the Secretary, the preceding provisions
4 of this section shall not apply to any dividend ex-
5 cludable from gross income under section 116(a)
6 and any distribution described in section 283(a).”

7 (c) MODIFICATION TO TREATMENT OF SECTION 1374
8 TAX.—

9 (1) Paragraph (2) of section 1366(f) is amend-
10 ed to read as follows:

11 “(2) TREATMENT OF TAX IMPOSED ON BUILT-
12 IN GAINS.—The amount of the items of the net rec-
13 ognized built-in-gain taken into account under sec-
14 tion 1374(b)(1) (reduced by any deduction allowed
15 under section 1374(b)(2)) shall not be taken into ac-
16 count under this section.”

17 (2)(A) Subsection (c) of section 1371 is amend-
18 ed by adding at the end the following new para-
19 graph:

20 “(B) EARNINGS AND PROFITS.—The accu-
21 mulated earnings and profits of the corporation
22 shall be increased at the beginning of the tax-
23 able year by the amount not taken into account
24 under section 1366 by reason of section

1 1366(f)(2) (determined without regard any re-
2 duction of such amount under section
3 1374(b)(2)) reduced by the tax imposed by sec-
4 tion 1374 (net of credits allowed).”

5 (B) Paragraph (1) of section 1371(c) is amend-
6 ed by striking “and (3)” and inserting “, (3), and
7 (4)”.

8 (d) REPEAL OF TAX AND TERMINATION WHERE EX-
9 CESS PASSIVE INVESTMENT INCOME.—

10 (1) REPEAL OF TAX.—

11 (A) IN GENERAL.—Section 1375 is re-
12 pealed.

13 (B) CONFORMING AMENDMENTS.—Sec-
14 tions 26(b)(2)(J) and 1366(f)(3) are repealed.

15 (2) REPEAL OF TERMINATION.—Section
16 1362(d) is amended by striking paragraph (3).

17 **SEC. 206. REPEAL OF ACCUMULATED EARNINGS TAX AND**
18 **PERSONAL HOLDING COMPANY TAX.**

19 (a) IN GENERAL.—Parts I and II of subchapter G
20 of chapter 1 (relating to corporations improperly accumu-
21 lating surplus and to personal holding companies) are
22 hereby repealed.

23 (b) CONFORMING AMENDMENTS.—

24 (1) Section 12 is amended by striking para-
25 graph (2) and by redesignating paragraphs (3), (4),

1 (5), (6), and (7) as paragraphs (2), (3), (4), (5),
2 and (6), respectively.

3 (2) Section 26(b)(2) is amended by striking
4 subparagraphs (F) and (G).

5 (3) Section 30A(c) is amended by inserting
6 “or” at the end of paragraph (1), by striking para-
7 graphs (2) and (3), and by redesignating paragraph
8 (4) as paragraph (2).

9 (4) Section 41(e)(7)(E) is amended by adding
10 “and” at the end of clause (i), by striking clause
11 (ii), and by redesignating clause (iii) as clause (ii).

12 (5) Section 56(b)(2) is amended by striking
13 subparagraph (C) and by redesignating subpara-
14 graph (D) as subparagraph (C).

15 (6) Section 111 is amended by striking sub-
16 section (d).

17 (7) Section 170(e)(4)(D) is amended by adding
18 “and” at the end of clause (i), by striking clause
19 (ii), and by redesignating clause (iii) as clause (ii).

20 (8) Sections 170(f)(10)(A), 508(d), 4947, and
21 4948(c)(4) are each amended by striking
22 “545(b)(2),” each place it appears.

23 (9)(A) Section 316(b) is amended by striking
24 paragraph (2) and by redesignating paragraph (3)
25 as paragraph (2).

1 (B) Section 331(b) is amended by striking
2 “(other than a distribution referred to in paragraph
3 (2)(B) of section 316(b))”.

4 (10) Section 341(d) is amended—

5 (A) by striking “section 544(a) (relating to
6 personal holding companies)” and inserting
7 “section 465(f) (relating to constructive owner-
8 ship rules)”, and

9 (B) by inserting before the period at the
10 end of the next to the last sentence “and such
11 paragraph (2) shall be applied by inserting ‘or
12 by or for his partner’ after ‘his family’ ”.

13 (11) Section 381(c) is amended by striking
14 paragraphs (14) and (17).

15 (12) Section 443(e) is amended by striking
16 paragraphs (1) and (2) and by redesignating para-
17 graphs (3), (4), and (5) as paragraphs (1), (2), and
18 (3), respectively.

19 (13) Section 447(g)(4)(A) is amended by strik-
20 ing “other than—” and all that follows and insert-
21 ing “other than an S corporation.”

22 (14)(A) Section 465(a)(1)(B) is amended to
23 read as follows:

24 “(B) a C corporation which is closely
25 held,”.

1 (B) Section 465(a)(3) is amended to read as
2 follows:

3 “(3) CLOSELY HELD DETERMINATION.—For
4 purposes of paragraph (1), a corporation is closely
5 held if, at any time during the last half of the tax-
6 able year, more than 50 percent in value of its out-
7 standing stock is owned, directly or indirectly, by or
8 for not more than 5 individuals. For purposes of this
9 paragraph, an organization described in section
10 401(a), 501(c)(17), or 509(a) or a portion of a trust
11 permanently set aside or to be used exclusively for
12 the purposes described in section 642(c) shall be
13 considered an individual.”

14 (C) Section 465(c)(7)(B) is amended by strik-
15 ing clause (i) and by redesignating clauses (ii) and
16 (iii) as clauses (i) and (ii), respectively.

17 (D) Section 465(c)(7)(G) is amended to read as
18 follows:

19 “(G) LOSS OF 1 MEMBER OF AFFILIATED
20 GROUP MAY NOT OFFSET INCOME OF PERSONAL
21 SERVICE CORPORATION.—Nothing in this para-
22 graph shall permit any loss of a member of an
23 affiliated group to be used as an offset against
24 the income of any other member of such group
25 which is a personal service corporation (as de-

1 fined in section 269A(b) but determined by sub-
2 stituting ‘5 percent’ for ‘10 percent’ in section
3 269A(b)(2)).”

4 (E) Section 465 is amended by adding at the
5 end the following new subsection:

6 “(f) CONSTRUCTIVE OWNERSHIP RULES.—For pur-
7 poses of subsection (a)(3)—

8 “(1) STOCK NOT OWNED BY INDIVIDUAL.—
9 Stock owned, directly or indirectly, by or for a cor-
10 poration, partnership, estate, or trust shall be con-
11 sidered as being owned proportionately by its share-
12 holders, partners, or beneficiaries.

13 “(2) FAMILY OWNERSHIP.—An individual shall
14 be considered as owning the stock owned, directly or
15 indirectly, by or for his family. For purposes of this
16 paragraph, the family of an individual includes only
17 his brothers and sisters (whether by the whole or
18 half blood), spouse, ancestors, and lineal descend-
19 ants.

20 “(3) OPTIONS.—If any person has an option to
21 acquire stock, such stock shall be considered as
22 owned by such person. For purposes of this para-
23 graph, an option to acquire such an option, and each
24 one of a series of such options, shall be considered
25 as an option to acquire such stock.

1 “(4) APPLICATION OF FAMILY AND OPTION
2 RULES.—Paragraphs (2) and (3) shall be applied if,
3 but only if, the effect is to make the corporation
4 closely held under subsection (a)(3).

5 “(5) CONSTRUCTIVE OWNERSHIP AS ACTUAL
6 OWNERSHIP.—Stock constructively owned by a per-
7 son by reason of the application of paragraph (1) or
8 (3), shall, for purposes of applying paragraph (1) or
9 (2), be treated as actually owned by such person;
10 but stock constructively owned by an individual by
11 reason of the application of paragraph (2) shall not
12 be treated as owned by him for purposes of again
13 applying such paragraph in order to make another
14 the constructive owner of such stock.

15 “(6) OPTION RULE IN LIEU OF FAMILY
16 RULE.—If stock may be considered as owned by an
17 individual under either paragraph (2) or (3) it shall
18 be considered as owned by him under paragraph (3).

19 “(7) CONVERTIBLE SECURITIES.—Outstanding
20 securities convertible into stock (whether or not con-
21 vertible during the taxable year) shall be considered
22 as outstanding stock if the effect of the inclusion of
23 all such securities is to make the corporation closely
24 held under subsection (a)(3). The requirement under
25 the preceding sentence that all convertible securities

1 must be included if any are to be included shall be
2 subject to the exception that, where some of the out-
3 standing securities are convertible only after a later
4 date than in the case of others, the class having the
5 earlier conversion date may be included although the
6 others are not included, but no convertible securities
7 shall be included unless all outstanding securities
8 having a prior conversion date are also included.”

9 (15)(A) Section 553(a)(1) is amended by strik-
10 ing “section 543(d)” and inserting “subsection (c)”.

11 (B) Section 553 is amended by adding at the
12 end the following new subsection:

13 “(c) ACTIVE BUSINESS COMPUTER SOFTWARE ROY-
14 ALTIES.—

15 “(1) IN GENERAL.—For purposes of subsection
16 (a), the term ‘active business computer software roy-
17 alties’ means any royalties—

18 “(A) received by any corporation during
19 the taxable year in connection with the licensing
20 of computer software, and

21 “(B) with respect to which the require-
22 ments of paragraphs (2), (3), and (4) are met.

23 “(2) ROYALTIES MUST BE RECEIVED BY COR-
24 PORATION ACTIVELY ENGAGED IN COMPUTER SOFT-
25 WARE BUSINESS.—The requirements of this para-

1 graph are met if the royalties described in paragraph
2 (1)—

3 “(A) are received by a corporation engaged
4 in the active conduct of the trade or business
5 of developing, manufacturing, or producing
6 computer software, and

7 “(B) are attributable to computer software
8 which—

9 “(i) is developed, manufactured, or
10 produced by such corporation (or its prede-
11 cessor) in connection with the trade or
12 business described in subparagraph (A), or

13 “(ii) is directly related to such trade
14 or business.

15 “(3) ROYALTIES MUST CONSTITUTE AT LEAST
16 50 PERCENT OF INCOME.—The requirements of this
17 paragraph are met if the royalties described in para-
18 graph (1) constitute at least 50 percent of the ordi-
19 nary gross income of the corporation for the taxable
20 year.

21 “(4) DEDUCTIONS UNDER SECTIONS 162 AND
22 174 RELATING TO ROYALTIES MUST EQUAL OR EX-
23 CEED 25 PERCENT OF ORDINARY GROSS INCOME.—

24 “(A) IN GENERAL.—The requirements of
25 this paragraph are met if—

1 “(i) the sum of the deductions allow-
2 able to the corporation under sections 162,
3 174, and 195 for the taxable year which
4 are properly allocable to the trade or busi-
5 ness described in paragraph (2) equals or
6 exceeds 25 percent of the ordinary gross
7 income of such corporation for such tax-
8 able year, or

9 “(ii) the average of such deductions
10 for the 5-taxable year period ending with
11 such taxable year equals or exceeds 25 per-
12 cent of the average ordinary gross income
13 of such corporation for such period.

14 If a corporation has not been in existence dur-
15 ing the 5-taxable year period described in clause
16 (ii), then the period of existence of such cor-
17 poration shall be substituted for such 5-taxable
18 year period.

19 “(B) DEDUCTIONS ALLOWABLE UNDER
20 SECTION 162.—For purposes of subparagraph
21 (A), a deduction shall not be treated as allow-
22 able under section 162 if it is specifically allow-
23 able under another section.

24 “(C) LIMITATION ON ALLOWABLE DEDUC-
25 TIONS.—For purposes of subparagraph (A), no

1 deduction shall be taken into account with re-
2 spect to compensation for personal services ren-
3 dered by the 5 individual shareholders holding
4 the largest percentage (by value) of the out-
5 standing stock of the corporation. For purposes
6 of the preceding sentence individuals holding
7 less than 5 percent (by value) of the stock of
8 such corporation shall not be taken into ac-
9 count.”

10 (16) Section 556(b)(1) is amended by striking
11 “, but not including” and all that follows and insert-
12 ing a period.

13 (17) Section 561(a) is amended by striking
14 paragraph (3), by inserting “and” at the end of
15 paragraph (1), and by striking “, and” at the end
16 of paragraph (2) and inserting a period.

17 (18) Section 562(b) is amended to read as fol-
18 lows:

19 “(b) DISTRIBUTIONS IN LIQUIDATION.—Except in
20 the case of a foreign personal holding company described
21 in section 552—

22 “(1) in the case of amounts distributed in liq-
23 uidation, the part of such distribution which is prop-
24 erly chargeable to earnings and profits accumulated
25 after February 28, 1913, shall be treated as a divi-

1 dend for purposes of computing the dividends paid
2 deduction, and

3 “(2) in the case of a complete liquidation occur-
4 ring within 24 months after the adoption of a plan
5 of liquidation, any distribution within such period
6 pursuant to such plan shall, to the extent of the
7 earnings and profits (computed without regard to
8 capital losses) of the corporation for the taxable year
9 in which such distribution is made, be treated as a
10 dividend for purposes of computing the dividends
11 paid deduction.

12 For purposes of paragraph (1), a liquidation includes a
13 redemption of stock to which section 302 applies. Except
14 to the extent provided in regulations, the preceding sen-
15 tence shall not apply in the case of any mere holding or
16 investment company which is not a regulated investment
17 company.”

18 (19) Section 563 is amended by striking sub-
19 sections (a) and (b), by redesignating subsections (c)
20 and (d) as subsections (a) and (b), and by striking
21 “, (b), or (c)” in subsection (b) (as so redesignated).

22 (20) Section 564 is hereby repealed.

23 (21) Section 631(c) is amended by striking the
24 next to the last sentence and inserting the following:

25 “‘This subsection shall have no application for pur-

1 poses of applying subchapter G (relating to corpora-
2 tions used to avoid income tax on shareholders).”.

3 (22) Section 852(b)(1) is amended by striking
4 “which is a personal holding company (as defined in
5 section 542) or”.

6 (23)(A) Section 856(h)(1) is amended to read
7 as follows:

8 “(1) IN GENERAL.—For purposes of subsection
9 (a)(6), a corporation, trust, or association is closely
10 held if the stock ownership requirement of section
11 465(a)(3) is met.”.

12 (B) Section 856(h)(3)(A)(i) is amended by
13 striking “section 542(a)(2)” and inserting “section
14 465(a)(3)”.

15 (C) Paragraph (3) of section 856(h) is amended
16 by striking subparagraph (B) and by redesignating
17 subparagraphs (C) and (D) as subparagraphs (B)
18 and (C), respectively.

19 (D) Subparagraph (C) of section 856(h)(3), as
20 redesignated by the preceding subparagraph, is
21 amended by striking “subparagraph (C)” and insert-
22 ing “subparagraph (B)”.

23 (24) The last sentence of section 882(c)(2) is
24 amended to read as follows:

1 “The preceding sentence shall not be construed to
2 deny the credit provided by section 33 for tax with-
3 held at source or the credit provided by section 34
4 for certain uses of gasoline.”.

5 (25) Section 936(a)(3) is amended by striking
6 subparagraphs (B) and (C), by inserting “or” at the
7 end of subparagraph (A), and by redesignating sub-
8 paragraph (D) as subparagraph (B).

9 (26) Section 936 is amended by striking sub-
10 section (g).

11 (27) Section 992(d) is amended by striking
12 paragraph (2) and by redesignating paragraphs (3),
13 (4), (5), (6), and (7) as paragraphs (2), (3), (4),
14 (5), and (6), respectively.

15 (28) Section 992 is amended by striking sub-
16 section (e).

17 (29) Section 1202(e)(8) is amended by striking
18 “section 543(d)(1)” and inserting “section
19 553(c)(1)”.

20 (30) Section 1298(b) is amended by striking
21 paragraph (8) and redesignating paragraph (9) as
22 paragraph (8).

23 (31) Section 1504(c)(2)(B) is amended by add-
24 ing “and” at the end of clause (i), by striking clause
25 (ii), and by redesignating clause (iii) as clause (ii).

1 (32)(A) Section 1551(a) is amended by striking
2 “or the accumulated earnings credit” and all that
3 follows and inserting “unless such transferee cor-
4 poration shall establish by the clear preponderance
5 of the evidence that the securing of such benefits
6 was not a major purpose of such transfer.”.

7 (B) The section heading for section 1551
8 is amended by striking “**AND ACCUMULATED**
9 **EARNINGS CREDIT**”.

10 (C) The item relating to section 1551 in
11 the table of sections for part I of subchapter B
12 of chapter 6 is amended by striking “and accu-
13 mulated earnings credit”.

14 (33)(A) Section 1561(a) is amended—

15 (i) by striking paragraph (2),

16 (ii) by redesignating paragraphs (3) and
17 (4) as paragraphs (2) and (3),

18 (iii) by striking “paragraph (3)” each
19 place it appears and inserting “paragraph (2)”,

20 (iv) by striking “paragraph (4)” and in-
21 serting “paragraph (3)”, and

22 (v) by striking the third sentence.

23 (B) Section 1561(b) is amended to read as fol-
24 lows:

1 “(b) CERTAIN SHORT TAXABLE YEARS.—If a cor-
2 poration has a short taxable year which does not include
3 a December 31 and is a component member of a controlled
4 group of corporations with respect to such taxable year,
5 then for purposes of this subtitle, the amount in each tax-
6 able income bracket in the tax table in section 11(b) for
7 such corporation for such taxable year shall be the amount
8 specified in subsection (a)(1), divided by the number of
9 corporations which are component members of such group
10 on the last day of such taxable year. For purposes of the
11 preceding sentence, section 1563(b) shall be applied as if
12 such last day were substituted for December 31.”.

13 (34) Section 2057(e)(2)(C) is amended by add-
14 ing at the end the following new sentence: “Ref-
15 erences to sections 542 and 543 in the preceding
16 sentence shall be treated as references to such sec-
17 tions as in effect on the day before their repeal.”

18 (35) Sections 6422 is amended by striking
19 paragraph (3) and by redesignating paragraphs (4)
20 through (12) and paragraphs (3) through (11), re-
21 spectively.

22 (36) Section 6501 is amended by striking sub-
23 section (f).

24 (37) Section 6503(k) of such Code is amended
25 by striking paragraph (1) and by redesignating

1 paragraphs (2) through (5) as paragraphs (1)
2 through (4), respectively.

3 (38) Section 6515 is amended by striking para-
4 graph (1) and by redesignating paragraphs (2)
5 through (6) as paragraphs (1) through (5), respec-
6 tively.

7 (39) Section 6601(b) is amended by striking
8 paragraph (4) and redesignating paragraph (5) as
9 paragraph (4).

10 (40) Subsections (d)(1)(B) and (e)(2) of section
11 6662 of such Code are each amended by striking “or
12 a personal holding company (as defined in section
13 542)”.

14 (41) Section 6683 is hereby repealed.

15 (42) Section 7518(c)(1) is amended by insert-
16 ing “and” at the end of subparagraph (C), by strik-
17 ing “, and” at the end of subparagraph (D) and in-
18 serting a period, and by striking subparagraph (E).

19 (c) CLERICAL AMENDMENTS.—

20 (1) The table of parts for subchapter G of
21 chapter 1 of such Code is amended by striking the
22 items relating to parts I and II.

23 (2) The table of sections for part IV of such
24 subchapter G is amended by striking the item relat-
25 ing to section 564.

1 (3) The table of sections for part I of sub-
2 chapter B of chapter 68 of such Code is amended
3 by striking the item relating to section 6683.

4 **SEC. 207. EFFECTIVE DATES.**

5 (a) IN GENERAL.—Except as otherwise provided in
6 this section, the amendments made by this title shall apply
7 to distributions received, and basis allocations made under
8 section 282 of the Internal Revenue Code of 1986 (as
9 added by this title), after December 31, 2002.

10 (b) SPECIAL RULES.—

11 (1) SECTION 1374 TAX.—In applying the
12 amendments made by this title, any tax imposed by
13 section 1374 of the Internal Revenue Code of 1986
14 for any taxable year beginning before January 1,
15 2003, shall not be taken into account.

16 (2) SECTION 205(D) AND 206.—The amendments
17 made by sections 205(d) and 206 shall apply to tax-
18 able years beginning after December 31, 2002; ex-
19 cept that—

20 (A) section 547 of such Code (as in effect
21 before its repeal) shall continue to apply to defi-
22 ciency dividends (as defined in section 547(d) of
23 such Code) relating to taxable years beginning
24 before January 1, 2003, and

1 (B) subsections (a) and (b) of section 563
2 of such Code (as so in effect) shall continue to
3 apply to dividends relating to taxable years be-
4 ginning before January 1, 2003.

5 Notwithstanding subparagraphs (A) and (B), such
6 dividends shall not be taken into account in applying
7 section 116 of such Code or part X of subchapter
8 B of chapter 1 of such Code.